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Nos. 90-1361 and 90-1484

In the Supreme Court of the United States

OCTOBER TERM, 1991

HOLYWELL CORPORATION, ET AL., PETITIONERS

v.

FRED STANTON SMITH, ETC., ET AL.

UNITED STATES OF AMERICA, PETITIONER

v.

FRED STANTON SMITH, ET AL.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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TABLE OF AUTHORITIES

Cases: Page

Caminetti v. *United States*, 242 U.S. 470 (1917) 6
Central National Bank v. *Commissioner*, 25 B.T.A. 1123 (1932) 5
Commissioner v. *Lane-Wells Co.*, 321 U.S. 219 (1944) 14
Commodity Futures Trading Comm'n v. *Weintraub*, 471 U.S. 343 (1985) 8
Crotts, In re, 87 B.R. 418 (Bankr. E.D. Va. 1988) 15
Danning v. *General Motors Acceptance Corp. (In re Jules Myers Pontiac, Inc.)*, 779 F.2d 480 (9th Cir. 1985) 15
Duvoisin v. *East Tennessee Equity, Ltd. (In re Southern Industrial Banking Corp.)*, 59 B.R. 638 (Bankr. E.D. Tenn. 1986) 11
First National Bank v. *United States*, 86 F.2d 938 (10th Cir. 1936) 8
Fribourg Navigation Co. v. *Commissioner*, 383 U.S. 272 (1966) 5
Haukos Farms, Inc., In re, 68 B.R. 428 (Bankr. D. Minn. 1986) 13
Helvering v. *Winmill*, 305 U.S. 79 (1938) 5
Hersloff v. *United States*, 310 F.2d 947 (Ct. Cl.), cert. denied, 373 U.S. 923 (1963) 8
I.J. Knight Realty Corp., In re, 501 F.2d 62 (3d Cir. 1974) 8, 9
Joplin, In re, 882 F.2d 1507 (10th Cir. 1989) 8
Kelderman, In re, 75 B.R. 69 (Bankr. S.D. Iowa 1987) 15
King v. *United States*, 379 U.S. 329 (1964) 12
Labor Board v. *Highland Park Mfg. Co.*, 341 U.S. 322 (1951) 6
Louisville Property Co. v. *Commissioner*, 140 F.2d 547 (6th Cir.), cert. denied, 322 U.S. 754 (1944) 8
Midlantic Nat'l Bank v. *New Jersey Dep't of Environmental Protection*, 474 U.S. 494 (1986) 12
National Muffler Dealers Ass'n v. *United States*, 440 U.S. 472 (1979) 5

Cases—Continued: Page

Nicholas v. *United States*, 384 U.S. 678 (1966) 3
North American Oil v. *Burnet*, 286 U.S. 417 (1932) 7, 8
Sonner, In re, 53 B.R. 859 (Bankr. E.D. Va. 1985) 11
T.S.P. Industries, Inc., In re, 120 B.R. 107 (Bankr. N.D. Ill. 1990) 11
United States v. *Dakota-Montana Oil Co.*, 288 U.S. 459 (1933) 5
United States v. *Loo*, 248 F.2d 765 (9th Cir. 1957), cert. denied, 356 U.S. 928 (1958) 8
United States v. *Ron Pair Enterprises, Inc.*, 489 U.S. 235 (1989) 6
United States v. *Sampsell*, 266 F.2d 631 (9th Cir. 1959) 8, 9
Westholt Mfg., Inc., In re, 20 B.R. 368 (Bankr. Kan. 1982), aff'd *sub nom. United States* v. *Redmond*, 36 B.R. 932 (D. Kan. 1984) 11

Statutes and regulations:

Bankruptcy Act, 11 U.S.C. 101 *et seq.*:

Ch. 3:

11 U.S.C. 322 4
11 U.S.C. 322(a) 4
11 U.S.C. 327 4
11 U.S.C. 363 2

Ch. 5:

11 U.S.C. 503(b)(1)(B) 2
11 U.S.C. 507(a)(1) 2

Ch. 7:

11 U.S.C. 704(1) 2
11 U.S.C. 721 8

Ch. 11:

11 U.S.C. 1104 2
11 U.S.C. 1108 8
11 U.S.C. 1123(b)(3) 4, 11
11 U.S.C. 1129(a)(1)(9)(A) 2
11 U.S.C. 1141(b) 10, 11

Statutes and regulations—Continued: Page

Internal Revenue Code (26 U.S.C.):

§ 1398 9
§ 6012 .... 13, 14
§ 6012(b) 2, 4, 5, 6, 12, 15
§ 6012(b)(3) 3, 5, 6, 7, 8, 9, 12
§ 6012(b)(4) 9, 10, 12
§ 6103(e)(4) 15
§ 6151 .... 12, 13, 14

31 U.S.C. 3713(a)(2) 3

Treas. Reg. (26 C.F.R.):

§ 1.1502-75(c)(1)(i) 15
§ 1.1502-75(c)(iii)(A) 15
§ 1.1502-77(a) 15

Treas. Reg. 86, art. 274-1 (1934 Revenue Act) 5
Treas. Reg. 94, art. 274-1 (1936 Revenue Act) 5
Treas. Reg. 101, art. 274-2 (1938 Revenue Act) 5
Treas. Reg. 103, § 19.274-1 (1939 Code) 5
Treas. Reg. 118, § 39.274-1(c) (1939 Code) 5

Miscellaneous:

H.R. Rep. No. 1337, 83d Cong., 2d Sess. (1954) 7
Plumb, *The Tax Recommendations of the Commission on the Bankruptcy Laws—Income Tax Liabilities of the Estate and the Debtor*, 72 Mich. L. Rev. 937 (1974) 7
Sheppard, *When Bankruptcy Courts Take Tax Laws Into Their Own Hands*, 15 Tax Notes 158 (Apr. 15, 1991) 9
S. Rep. No. 1622, 83d Cong., 2d Sess. (1954) 7
S. Rep. No. 989, 95th Cong., 2d Sess. (1978) 9

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1. A conspicuous and important analytical error permeates respondents' discussion of this case. Respondents claim that the liquidating trustee should have no liability for taxes on the income he receives because, in what they term the "typical" liquidating bankruptcy, the ultimate distributions made to creditors are not reduced by taxes (Bank Br. 11, 13-15; Smith Br. 17, 40-41). In the so-called "typical" liquidating bankruptcy, the liquidation of the debtor's assets is conducted by the estate, and the income realized from that liquidation is taxed in the

hands of the estate, *before* ultimate distribution is made to creditors. In such a "typical" liquidating bankruptcy, the *net* assets remaining for distribution to creditors are thus *already reduced* by taxes before distribution occurs.[1] In the supposedly non-typical situation that the present case represents, "all or substantially all" of the assets of the estate are placed in the hands of a liquidating trustee who conducts the liquidation. In this situation, 26 U.S.C. 6012(b) ensures that precisely the same final result is accomplished as in the "typical" case: when the liquidating trustee liquidates the assets, realizes income, and then reports and pays the taxes owed on the income, the trustee will have the same *net* assets remaining for distribution to the creditors as the estate would have in the "typical" case.

By contrast, the result respondents seek would allow the income realized upon liquidation of a debtor's assets to escape effective taxation through the simple artifice of placing those assets in the sheltering hands of a liquidating trustee (appointed by the bankruptcy court) *before* liquidation. It is clearly illogical to suggest that Congress intended to allow liquidating trustees who receive "all or substantially all" of the debtor's assets to serve as a tax sheltering device to enhance net distributions for creditors in a bankruptcy case. Moreover, as we discuss next,

[1] Respondents seem to acknowledge (Smith Br. 26; Bank Br. 29-31) that, if the debtors' assets had been sold in a Chapter 7 liquidation, the trustee of the debtors' estate would have been required by 26 U.S.C. 6012(b) to pay taxes on the income realized in liquidation before making distribution to creditions. See 11 U.S.C. 704(1), 503(b)(1)(B), 507(a)(1). They also agree (Smith Br. 26; Bank Br. 29-30) that the same result would have occurred if the debtors' assets had been liquidated by a trustee appointed prior to confirmation of a Chapter 11 reorganization plan. See 11 U.S.C. 363, 1104, 1129(a)(1)(9)(A). Indeed, even in a typical reorganization, where the assets of the estate are revested in a reorganized debtor, the debtor makes payments to creditors under the plan in after-tax dollars.

respondents' claim is contrary to the plain language and consistent administrative construction of the statute.

2. a. Respondents contend that the liquidating trustee is not a "trustee in a case under title 11," as that term is used in Section 6012(b)(3). But respondents ultimately concede (i) that this is a "case under title 11," (ii) that the liquidating trustee was appointed as part of this "case under title 11," (iii) that the liquidating trustee continues to serve as a trustee in this "case under title 11," and (iv) that the liquidating trustee is, in fact, a "trustee." See Bank Br. 37, 41; Smith Br. 35-36. Respondents' sole rationale for their claim that Section 6012(b)(3) does not apply to the trustee appointed in this case is that the statutory phrase "trustee in a case under title 11" is a special "term of art" that conveniently excludes liquidating trustees. This contention is insubstantial.

It is telling that the trustee asserts that he *is* a trustee acting in "a case under title 11" for purposes of 31 U.S.C. 3713(a)(2), which he mistakenly claims immunizes him from any breaches of trust he may have committed (see Smith Br. 35 & n.31).[2] This concession emphasizes the transparent expediency of his conflicting assertion that he is not a "trustee in a case under title 11" for purposes of 26 U.S.C. 6012(b)(3), which requires him to report and pay taxes on the income he has received. We are offered no insight into why the phrase "trustee in a case under title 11" is a "term of art," but the phrase "trustee acting under title 11" is not.

The assertion that the phrase "trustee in a case under title 11" is a "term of art" is based by respondents on

[2] The trustee asserts that his liability as trustee is limited to the assets "remaining" in his hands. Smith Br. 34 n.31. He cites no authority for this proposition. In fact, his liability is at least co-extensive with the assets originally "placed" in his hands. See *Nicholas* v. *United States*, 384 U.S. 678, 694 n.28 (1966). If he has breached his obligation to pay taxes owed the United States, he cannot defeat recovery by the mere fact that he has paid estate assets improperly to third parties or to creditors. *Ibid.*

various provisions of the Bankruptcy Code that define the varying responsibilities of various types of trustees in various types of cases under Title 11 (see Bank Br. 29-31; Smith Br. 26). None of these provisions, of course, purports to define (or even address or consider) the phrase "trustee in a case under title 11." Indeed, the provision on which respondents principally rely refers only to persons "selected under section 701, 702, 703, 1104, 1163, 1302, or 1202 of this title to serve as a trustee in a case under this title" (11 U.S.C. 322(a)), which plainly indicates that Congress understood that there are *other* types of "trustees in a case under title 11" than those described in that provision.

The term "trustee" is not used in a uniform fashion throughout the Bankruptcy Code. In some instances, the phrase "trustee in a case under this title" is employed. See 11 U.S.C. 322. In other contexts, the term "trustee" stands alone. See 11 U.S.C. 327. In still others, the term "trustee" is used in connection with events that can occur only *after* a plan of reorganization is confirmed. See 11 U.S.C. 1123(b)(3). These many variations with which Congress has used the term "trustee" in the Bankruptcy Code refute respondents' unsupported claim that the phrase "trustee in a case under title 11" in Section 6012(b) of the Internal Revenue Code is a term of art. There is utterly no evidence in the legislative history of the statute to support respondents' novel view.

As our opening brief explains (Br. 18), the language of Section 6012(b) has long appeared in revenue statutes and has consistently been interpreted by the Treasury to have a far broader meaning than that claimed by respondents. The original statutory phrase "trustee in bankruptcy," which was supplanted by the phrase "trustee in a case under title 11" in 1980,[3] has consistently been

[3] Respondents acknowledge that the change in the statutory language does not affect the proper outcome of this case, for it "was merely a technical amendment to conform to the terminology of the new Bankruptcy Code." Smith Br. 27.

construed in revenue statutes in a broad and functional manner to include "a trustee, receiver, debtor in possession, *or other person designated as in control of the assets of a debtor in any bankruptcy proceeding by order of the court* in which such proceeding is pending." Treas. Reg. 103, § 19.274-1 (Internal Revenue Code of 1939) (emphasis supplied).[4] Moreover, as we have described in detail (Br. 16-17), the Treasury Regulations interpreting Section 6012(b)(3) and its predecessors have specifically interpreted the phrase "trustee in bankruptcy" to include "trustees in dissolution." See also *Central National Bank* v. *Commissioner*, 25 B.T.A. 1123, 1128 (1932). The language of this statute has never been interpreted by the Treasury as a "term of art" that refers only to a limited class of trustees specifically described in particular Bankruptcy Code provisions. Because the agency's contemporaneous and consistent administrative interpretations of this provision of the Internal Revenue Code "implement the congressional mandate in [a] reasonable manner," they should be upheld (*National Muffler Dealers Ass'n* v. *United States*, 440 U.S. 472, 476 (1979)).[5]

b. Respondents also err in their cramped interpretation of the terms "assignee" and "receiver" as they appear in Section 6012(b). According to respondents (Bank Br. 38-40, 42; Smith Br. 28), these terms have no application to this case because this is a bankruptcy case under

[4] Accord: Treas. Reg. 86, art. 274-1 (Revenue Act of 1934); Treas. Reg. 94, art. 274-1 (Revenue Act of 1936); Treas. Reg. 101, art. 274-1 (Revenue Act of 1938); Treas. Reg. 118, § 39.274-1(c) (1939 Code).

[5] This Court has repeatedly stated that when Congress has, in many reenactments of a tax statute, declined to override a contemporaneous and long-continued administrative construction, the agency's interpretation "must be deemed to have received congressional approval" and to have the effect of law. *Fribourg Navigation Co.* v. *Commissioner*, 383 U.S. 272, 283 (1966). See also *Helvering* v. *Winmill*, 305 U.S. 79, 82-83 (1938); *United States* v. *Dakota-Montana Oil Co.*, 288 U.S. 459, 466 (1933).

Title 11. The irony of this position is rather extraordinary. On the one hand, the trustee claims that he is not subject to Section 6012(b)(3) because he is not a trustee "in a case under title 11"; on the other hand, he claims that he is not subject to Section 6012(b)(3) because this is "a case under title 11" and the terms "assignee" and "receiver" therefore cannot apply. Respondents offer nothing in the statutory language or legislative history to support this implausible claim. Nor do they cite a single case which has so limited the broad provisions of Section 6012(b).

This Court has often stated that "the meaning of a statute must, in the first instance, be sought in the language in which the act is framed, and if that is plain * * * the sole function of the courts is to enforce it according to its terms." *Caminetti* v. *United States*, 242 U.S. 470, 485 (1917). See also *United States* v. *Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241 (1989). For the reasons set forth in our opening brief (Br. 25-27), the terms "assignee" and "receiver" in Section 6012(b) should be interpreted in accordance with their ordinary meaning to encompass the liquidating trustee in this case. That ordinary interpretation of the statutory language reaches results "consistent with the context and purpose of" the statute (*Labor Board* v. *Highland Park Mfg. Co.*, 341 U.S. 322, 325 (1951)).[6]

[6] Contrary to the Bank's claim (Bank. Br. 41-42), affording these terms their ordinary meaning does not render the phrase "trustee in a case under title 11" superfluous. If the phrase "trustee in a case under title 11" has the restrictive meaning claimed by respondents, it would be reasonable to believe that Congress intended the phrase "assignee" or "receiver" to cover individuals not within the former designation, even if they obtained title or possession of a corporation's property in the context of a bankruptcy case. It is not reasonable to assume, as respondents would have it, that Congress meant to give an unnaturally restrictive meaning to the term, thereby leaving gaps to be exploited by inventive creditors.

c. Central to respondents' misconstruction of Section 6012(b)(3) is their repeated claim that the statute applies *only* when a fiduciary supplants corporate management and controls the operations of a debtor.[7] See Bank Br. 34-36; Smith Br. 23-25. This contention utterly lacks foundation. It is also flatly refuted by the fact that, in 1954, Congress expressly *eliminated* the preexisting statutory language that had made a fiduciary responsible for the corporate filing requirement only if he was "operating the business or property" of the corporation (see Br. 17 n.11). Section 6012(b)(3) now imposes that responsibility on fiduciaries and trustees "whether or not such property or business is being operated." 26 U.S.C. 6012(b)(3).[8] Respondents simply ignore—and by

[7] Respondents assert (Bank Br. 35-36; Smith Br. 31-33) that the corporate debtors have emerged from bankruptcy and are now being "operated" under their own management. It is true that they continue to litigate with the trustee; but they were left, under the Bank's plan, with nothing. That plan provided for transfer of all of the corporate debtors' assets to the liquidating trust (J.A. 41). Debtors' management was left in charge of the shell; the trustee had the assets. Under the circumstances, respondents' irrelevant assertion that the trustee has not "supplanted" corporate management is purely formalistic.

[8] See H.R. Rep. No. 1337, 83d Cong., 2d Sess. A396 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 563 (1954). In support of their argument, respondents rely (Bank Br. 41, Smith Br. 24-25) on that portion of this Court's opinion in *North American Oil* v. *Burnet*, 286 U.S. 417, 423 (1932), which states that the *predecessor* of Section 6012(b)(3) applied "when the receiver is in complete control of the properties and business of the corporation." Respondents fail to note, however, that this language refers to the statute as it existed prior to its amendment. Nothing in *North American Oil*, of course, suggests that the former "operational" requirement of the statute survives to this day. See Plumb, *The Tax Recommendations of the Commission on the Bankruptcy Laws—Income Tax Liabilities of the Estate and the Debtor*, 72 Mich. L. Rev. 937, 943 (1974). Moreover, the receiver in *North American Oil* operated only one section of oil land "[a]mong [the] many properties" of the corporation. The Court's concern that there be a "substitution of the receiver for the corporation" and that the receiver be in "com-

ignoring fail to account for—the plain language of the statute.[9]

It has long been recognized that the statute this case involves does not make distinctions that turn on the breadth of the "discretion" afforded to the "trustee," "receiver" or "assignee." The authority of the persons who have been held responsible for taxes under Section 6012(b)(3) has been derived from a variety of sources: state statutes (*Hersloff* v. *United States*, 310 F.2d 947 (Ct. Cl.), cert. denied, 373 U.S. 923 (1963); *United States* v. *Loo*, 248 F.2d 765 (9th Cir. 1957), cert. denied, 356 U.S. 928 (1958)); federal statutes (*In re Joplin*, 882 F.2d 1507 (10th Cir. 1989); *In re I.J. Knight Realty Corp.*, 501 F.2d 62 (3d Cir. 1974); *United States* v. *Sampsell*, 266 F.2d 631 (9th Cir. 1959)); and deeds of assignment or trust (*Louisville Property Co.* v. *Commissioner*, 140 F.2d 547 (6th Cir.), cert. denied, 322 U.S. 754, 755 (1944); *First National Bank* v. *United States*, 86 F.2d 938 (10th Cir. 1936)). But the scope of authority conferred on these fiduciaries—beyond the basic authority to dispose of assets and invest proceeds—was not a point of importance in any of these cases. Rather, the relevant similarities between these fiduciaries were that they had possession of or title to the debtor's property and produced

plete control" of the corporate properties and business must be understood in that context. 286 U.S. at 420, 423. When Congress clarified the predecessor of Section 6012(b)(3) by deleting the operational requirement, it made clear that application of the statute depends on the *amount* of the corporate property in the hands of the fiduciary ("all or substantially all"), not the manner in which it is held.

[9] It is also significant that even the "statutory trustees" that respondents admit are subject to Section 6012(b)(3) do not always assume operational control of the debtor's business. For example, in a Chapter 11 reorganization, a trustee may operate the debtor's business "unless the court * * * orders otherwise." 11 U.S.C. 1108. Similarly, in a Chapter 7 liquidation, the court "may" authorize the trustee to operate the business of the debtor for a limited period of time. 11 U.S.C. 721; see *Commodity Futures Trading Comm'n* v. *Weintraub*, 471 U.S. 343, 352 (1985).

taxable income from that property. See *In re I.J. Knight Realty Corp.*, 501 F.2d at 66; *United States* v. *Sampsell*, 266 F.2d at 634-635. No more is required for Section 6012(b)(3) to apply.[10]

3. a. A separate taxable entity, the individual debtor's estate, was created when Mr. Gould filed for relief under Chapter 11. 26 U.S.C. 1398. At the same time, Mr. Gould continued as a taxpayer in his own right outside of bankruptcy. Although respondents appear to acknowledge that distinction (Bank Br. 22; Smith Br. 19), they incorrectly complain that the government's construction of Section 6012(b)(4) would shift to the liquidating trustee the responsibility for reporting income and paying taxes *of the individual* (Bank Br. 21; Smith Br. 21). We willingly join with respondent in tearing that straw man apart: Mr. Gould will continue to bear tax responsibility for his income. The liquidating trustee, by operation of Section 6012(b)(4), bears tax responsibility only for the income attributable to Mr. Gould's bankruptcy estate—income that the trustee, rather than Mr. Gould, received.

Contrary to respondents' assertion (Bank Br. 22-24; Smith Br. 20), the obligations of the liquidating trustee under Section 6012(b)(4) are not altered by the fact that Mr. Gould preceded the trustee as fiduciary of the bankruptcy estate prior to confirmation of the reorganization plan. In his capacity as debtor in possession, Mr. Gould held the property of the estate for the benefit of creditors, stepping into "the shoes of a trustee in every way." S. Rep. No. 989, 95th Cong., 2d Sess. 116 (1978). While he held that position, Mr. Gould was required by Section 6012(b)(4) to file returns on behalf of the es-

[10] See Sheppard, *When Bankruptcy Courts Take Tax Laws Into Their Own Hands*, 15 Tax Notes 158, 161 (Apr. 15, 1991) ("Under the express wording of section 6012, th[e] fiduciary does not have to be operating the debtor's business. He does not have to have the discretionary powers of a trustee appointed under section 1104(a) of the Bankruptcy Code. All the fiduciary contemplated by section 6012 has to do is hold title to substantially all of the debtor's business assets.").

tate.[11] But Mr. Gould's fiduciary control over the estate property terminated when the plan was confirmed and the property was transferred to the liquidating trust. The returns and taxes at issue in this case were due *after* Mr. Gould's tenure as fiduciary of the estate and during the tenure of the liquidating trustee.

b. Respondents claim that Section 6012(b)(4) does not obligate the liquidating trustee to file returns of income generated by property he has held in the liquidating trust because the liquidating trustee is not a fiduciary of a bankruptcy "estate." According to respondents, even though all of the property of Mr. Gould's estate passed to the liquidating trustee to hold and administer after confirmation of the reorganization plan, the estate ceased to exist (Bank Br. 23; Smith Br. 20). As the sole statutory support for this critical proposition, respondents cite 11 U.S.C. 1141(b), which states:

> (b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

Although it would seem plain enough on the face of this provision that it does not dictate the end of the bankruptcy estate when, as in this case, confirmation of the reorganization plan does *not* vest all of the property of the estate in the debtor, respondents urge that such is "settled law" (Smith Br. 20 n.17). The cases cited by respondents (Bank Br. 23 n.19; Smith Br. 20 n.17), however, only confirm that 11 U.S.C. 1141(b) implies nothing of the sort.[12] Of the eleven bankruptcy and district court cases upon which respondents rely (they cite no higher authority), all but one involved plans that called for all

[11] At the same time, he remained responsible for filing returns on his own behalf as an individual taxpayer.

[12] We note that the debtors also seem to assume that plan confirmation terminates the estate (Holywell Br. 30 n.34), but they also offer no pertinent authority on the matter.

of the estate property to vest in the debtor.[13] See, *e.g.*, *In re Westholt Mfg., Inc.*, 20 B.R. 368, 372 (Bankr. Kan. 1982) ("At confirmation, all the property of the estate is vested in the debtor, *thereby* terminating the estate's existence * * *.") (emphasis added), aff'd *sub nom. United States* v. *Redmond*, 36 B.R. 932 (D. Kan. 1984); *In re T.S.P. Industries, Inc.*, 120 B.R. 107, 109 (Bankr. N.D. Ill. 1990) (when estate property vests in debtor, "title to property revests in the debtor along with normal ownership rights and is then no longer property of the estate") (internal quotation marks omitted). Where the plan provides that property of the estate is to be transferred to another fiduciary for administration, neither 11 U.S.C. 1141(b) nor the cases construing it suggest that the estate ceases to exist.

Indeed, the Bankruptcy Code explicitly provides that a fiduciary may continue to hold and administer property of the estate *after* a plan is confirmed. Under 11 U.S.C. 1123(b)(3), a plan may provide for "the retention and enforcement by the debtor, by the trustee, or by a representative of the estate appointed for such purpose," of "any claim or interest belonging to the debtor or to the estate." The Bankruptcy Code thus plainly contemplates that the estate may continue to exist and be represented by a fiduciary after confirmation. See *Duvoisin* v. *East Tennessee Equity, Ltd. (In re Southern Industrial Banking Corp.)*, 59 B.R. 638, 642 (Bankr. E.D. Tenn. 1986); *In re T.S.P. Industries, Inc.*, 120 B.R. at 109 n.2 (describing debtor's additional fiduciary responsibilities when "property of the estate remain[s] property of the estate after confirmation").

[13] In the remaining case, *In re Sonner*, 53 B.R. 859 (Bankr. E.D. Va. 1985), the bankruptcy court merely invoked 11 U.S.C. 1141(b) and recited that the estate was "terminated," notwithstanding that the estate property was transferred to a creditors' trust and was not revested in the debtor. See 53 B.R. at 864. That unexamined conclusion is, we submit, wrong.

In the present case, Mr. Gould was not revested with the estate property upon confirmation. Instead, the estate, in its entirety, passed to the liquidating trustee. From the time of that transfer, Section 6012(b)(4) requires the trustee, not Mr. Gould, to file returns reflecting the income of the estate.

4. The Bank tacitly admits (Bank Br. 47) that it was its secret intent from the outset to subvert the trustee's statutory duty to pay federal income taxes by proposing a plan of liquidation that made no express provision for the payment of taxes. The trustee, however, was obviously unsure that the Bank's hidden agenda had been accomplished, for he commenced this adversary proceeding in the bankruptcy court to obtain a determination whether he should report and pay taxes, as 26 U.S.C. 6012(b) and 6151 expressly require.[14] The trustee now asserts (Smith Br. 46), however, that the courts below held that the plan of liquidation positively does not permit payment of taxes and that it is therefore too late for the government to demand his compliance with the tax laws. This argument is demonstrably unsound.

a. In respondents' view (Bank Br. 15; Smith Br. 44-46), unless the plan specifically provides that the trustee is to obey the law by filing returns and paying taxes, the trustee is not only free, but is *required*, to ignore those obligations. That startling assertion ignores the rather basic fact that the Bankruptcy Code does not grant the trustee "*carte blanche* to ignore nonbankruptcy law." *Midlantic Nat'l Bank* v. *New Jersey Dep't of Environmental Protection*, 474 U.S. 494, 502 (1986). In particular, nothing in the Code authorizes a "trustee in a case under title 11" (26 U.S.C. 6012(b)(3)) to ignore his specific statutory duty to report and pay taxes.

The plan of reorganization, in any event, lends no support to respondents' claim. The plan does not state that

[14] See *King* v. *United States*, 379 U.S. 329, 338-339 (1964) (trustee personally liable for failing to seek amendment to plan to pay taxes).

the debtors, rather than the trustee, will report and pay taxes on the income generated by the trust.[15] Indeed, to the extent the plan suggests anything regarding the trustee's tax responsibilities, it empowers him to pay and discharge all lawful claims against the trust assets and provides that "[a]ll * * * obligations incurred by the Trustee in administering the Trust or in any manner connected, incidental or related thereto, shall be a charge against the Trust Property" (Pet. App. 9a). Since the trustee's duties to report and pay taxes under 26 U.S.C. 6012 and 6151 create a valid "charge against the Trust Property," the plan in this manner provides a direct basis for the trustee to pay the taxes as required by law. In this context, the absence of an IRS objection to the proposed plan is hardly remarkable.[16]

The standard procedure for collection of post-petition taxes is for the trustee to file returns and pay the tax

[15] The proponent of a plan is not entitled to remain silent about the tax consequences that it believes will result from liquidation of property under the plan, particularly if it takes the position that the taxes will be borne by persons other than those to whom the debtor's assets are to be transferred. See *In re Haukos Farms, Inc.*, 68 B.R. 428, 434 (Bankr. D. Minn. 1986). In marked contrast to his current posture, the liquidating trustee at one time viewed the Bank's failure to disclose its intentions regarding who was to bear the tax burden on income and gains generated by the trust as "a material act of omission" (II C.A. App. Tab J, Tr. 91).

[16] The trustee errs (Smith Br. 46) in faulting the IRS for failing to file a proof of claim with respect to tax liabilities arising out of the trust administration. Under its longstanding procedures, the IRS files proofs of claims for a debtor's pre-petition tax liabilities, as it did in this case. But the claims for liabilities generated by the liquidating trust are not pre-petition claims. Indeed, taxes on the post-petition gains and investment income received by the trust were not even due when, on October 10, 1985, the plan was implemented by sale of the Miami Center. Since the IRS could not have filed a claim for the taxes at issue before the plan was implemented, the Bank and trustee could hardly have relied on the lack of such a claim in implementing the plan.

reported due, as 26 U.S.C. 6012 and 6151 require. Our system of taxation depends upon such self-assessment. *Commissioner* v. *Lane-Wells Co.*, 321 U.S. 219, 223 (1944). Once the return is filed by the trustee, the Internal Revenue Service may request payment of any amount not paid with the return as an expense of administration. It may also select the return for audit and, if it finds a deficiency, may request payment of the deficiency on the same basis. The fact that the IRS has not yet formalized its claim against the trust for post-petition income in this case reflects only the failure of the trustee to file required returns, not a breakdown in internal procedures on the part of the IRS.[17]

In any event, as the court of appeals recognized (Pet. App. 7a), the government does not seek to alter the plan, but only to require the trustee to abide by applicable law and pay the taxes due under the provisions of the plan. Nor is there any unfairness in what the trustee perceives as his current predicament.[18] The trustee could have

[17] Respondents complain (Bank Br. 43-44; Smith Br. 10 n.10, 43) that there is no basis in the record for estimating the taxes that may be due in this case. Although the amount of that liability is not directly relevant to the question of who must file returns and pay the tax (and was therefore never addressed in the adversary proceeding below), we indicated in our opening brief that the amount of taxes and interest owing for Holywell's 1986 tax year would be substantial (Br. 6 n.4). In the absence of any return, the revenue agent has now completed a draft report of his audit of Holywell and its subsidiaries for the years 1986 through 1991. Copies of the report have been released to Holywell and the trustee. The report indicates that the total liability for the consolidated group for the 1986 tax year, with interest to October 8, 1991, exceeds $32,293,000.

[18] Respondents claim (Bank Br. 20; Smith Br. 30-31) that the trustee would be faced with a "virtually impossible task" if required to file consolidated returns on behalf of the debtor corporations because only some of the companies in the consolidated group (of which Holywell Corporation is the parent) filed for bankruptcy. This practical concern, of course, has nothing to do with any legal issue in this case: the trustee's lot here is no different from that of

taken more adequate steps to resolve any doubts he harbored about his obligations under the plan and under the Internal Revenue Code. He should, of course, have brought this proceeding *before* he began to distribute trust proceeds. His failure to take appropriate action to escrow or pay the taxes due (and seek a refund, if appropriate), and his actions in disbursing funds prior to a final judgment in this case, cannot be blamed on the IRS.[19]

the "statutory trustees" that respondents readily admit are subject to the requirements of Section 6012(b).

In any event, the difficulties that respondents claim the trustee will have in complying with Section 6012(b) are largely illusory. Respondents neglect to point out that the stock of the subsidiaries that did *not* file for bankruptcy is part of the corpus of the liquidating trust. Moreover, under the Treasury's consolidated return regulations, the parent corporation is "the sole agent for each subsidiary in the [consolidated] group, duly authorized to act in its own name in all matters relating to the tax liability for the consolidated return year." Treas. Reg. § 1.1502-77(a). Congress anticipated that the trustees of parent corporations would need to obtain information to meet corporate filing responsibilities and specifically authorized the Internal Revenue Service to provide a "trustee in a title 11 case" or a "receiver" possessing substantially all of a taxpayer's assets with information regarding prior returns filed by a taxpayer. 26 U.S.C. 6103(e)(4). If the trustee regards his difficulties as insurmountable, he may seek leave from the Commissioner to discontinue filing consolidated returns "for good cause" under Treasury Regulation Section 1.1502-75(c)(1)(i). The factors taken into account in determining whether "good cause" exists include "[c]hanges in law or circumstances, including changes which do not affect Federal income tax liability." Treas. Reg. § 1.1502-75(c)(1)(iii)(A).

[19] See also note 2, *supra*. The trustee is not without means to attempt to alleviate his predicament. As he mentions (Smith Br. 12 n.13), the bankruptcy court did not reach his "contingent allegation" that the Bank was responsible for misleading him, and he may be able to recover from the Bank on that basis. The trustee could also seek to recover payments he made to the Bank and other creditors in excess of their proper share of the net distribution available after taxes are properly paid. See *Danning* v. *General Motors Acceptance Corp. (In re Jules Meyers Pontiac, Inc.)*, 779 F.2d 480 (9th Cir. 1985); *In re Crotts*, 87 B.R. 418, 421 (Bankr. E.D. Va. 1988); *In re Kelderman*, 75 B.R. 69 (Bankr. S.D. Iowa 1987).

b. Respondents claim (with no small irony) that the result in this case could have been avoided by greater vigilance on the part of the IRS in policing the plan confirmation process (Bank. Br. 46; Smith Br. 44). The statute, however, places this duty of vigilance on the trustee, not the government. Moreover, the court of appeals' decision has the potential for great mischief. The court of appeals has constructed out of whole cloth a new tax-exempt entity—the liquidating trust—that creditors may use to maximize their distributions in bankruptcy at the expense of the public fisc. Although respondents shrink from our characterization of this as a "tax loophole," this label perfectly describes a statutory construction that leaves the government with only the hollow right of seeking payment of taxes from the debtors *after* the creditors have obtained *all* the debtors' assets by transferring them to the liquidating trust.[20]

For the foregoing reasons and those stated in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

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Solicitor General

OCTOBER 1991

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[20] The Bank would take the government to task for noting that the debtors "evidently lack funds" to satisfy their substantial tax liabilities (Bank Br. 44-45). The Bank maintains that there is "no evidence in the record" to support that assertion. To the contrary, the record is quite clear that the confirmed plan placed *all* the corporate assets in the liquidating trust, *including* the stock of the non-debtor subsidiaries. Since "all" of their assets were taken, it seems a fair inference—indeed a rather obvious inference—that these debtors "lack funds" to pay the taxes on the income the *trustee* received.

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